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Better Incentives Data Can Inform Both Research and Policy

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EMPLOYMENT RESEARCH

Better Incentives Data Can Inform Both Research and Policy

Timothy J. Bartik

ARTICLE HIGHLIGHTS

■ *Incentives tripled from 1990 to 2015, increasing from 9 percent of state/local business taxes to 30 percent.*

■ *Incentives often vary by a factor of 2 or 3 to 1 across nearby states, for no clear economic reason and with no obvious economic consequences.*

■ *States underinvest in customized business services and overinvest in tax incentives for low-wage businesses and long-term incentives.*

In March 2017 the Upjohn Institute released a new, publicly accessible database on economic development incentives, which are those offered by state and local governments as their “usual deal” to entice a business to locate a new facility. (The database is housed on the Upjohn Institute’s website: www.upjohn.org/models/bied/home.php.) These incentives include property tax abatements, job creation tax credits, investment tax credits, and R&D tax credits. They also include customized job training programs, under which community colleges provide a new facility with training for new workers that is customized to the facility’s needs.

No other study of incentives is as comprehensive in covering diverse industries and lengthy time periods. Using data from 1990 to 2015, the “Panel Database on Incentives and Taxes” estimates marginal business taxes and business incentives for 45 industries in 33 states; the industries compose 91 percent of U.S. labor compensation, and the states produce over 92 percent of U.S. economic output. The database has data for a new facility starting up in each of 26 “start years.” Compared to prior studies, the new database provides more incentive details, such as how incentives are broken down by different incentive types (e.g., job creation tax credits vs. property tax abatements), and the time pattern by which incentives are paid out over a facility’s life cycle.

The purpose of this new database is to help researchers and policymakers learn more about incentives and their effectiveness. Without knowing how different incentives vary over time and across industries for different states, it is impossible to conduct any meaningful incentives research or to subject incentives to any informed public debate. Do incentive differences across states, industries, or time lead to any significant effects on an industry’s growth in a state? Do incentives allocate more U.S. growth to needier areas or to industries that might boost national

productivity? Without incentives data, such questions cannot begin to be addressed.

In addition to being downloadable, the database is analyzed in an accompanying report (Bartik 2017) that focuses on 31 “export-base” industries, which are those that sell their goods and services outside the state but not necessarily outside the country. Such industries provide the base for a

The typical state does little industry targeting—for example, higher-wage industries do not receive significantly higher incentives.

state’s economy by bringing new money into the state. This article highlights the main findings in the report.

Incentives are Large Compared to State and Local Business Taxes but Modest as a Share of Overall Costs

Incentives for the average state’s base industries in 2015 offset around 30 percent of what otherwise would be charged in state and local business taxes. Incentives play a significant role in state and local taxes and budgets.

On the other hand, incentives for base industries average about 1.4 percent of business value-added, a measure of the value of the business’s production. (Business value-added is defined as the business’s sales minus what it purchases from other businesses.) Incentives can be offset by modest variations in other business costs, such as wages.

Incentives Tripled from 1990 to 2015

Average incentives increased from 9 percent of business taxes in 1990 to 30 percent in 2015. As shown in Figure 1, this increase was most rapid

ALSO IN THIS ISSUE

Working Longer,
Retiring Later

Robert L. Clark and
Melinda Sandler Morrill
page 4

Better Incentives Data Can Inform Both Research and Policy

in the 1990s. In the past decade, some states have significantly expanded incentives while other states have made cuts.

Incentives Vary Greatly across Nearby States, with No Obvious Strong Correlation with a State's Economic Past or Future

As shown in Figure 2, incentives often vary by a factor of 2 to 1 or more across nearby states. These incentive differences are not tied to a state's unemployment, so incentives are not reallocating jobs to high unemployment areas.

Incentive differences do not appear to have large effects on state economic growth by industry. The database suggests incentive effects toward the low end of prior estimates: the average incentive package, 1.4 percent of value-added, might tip the location decision of 6 percent of incented businesses—the other 94 percent of the time, the

state would have experienced similar growth without the incentive.

This typical 6 percent tip rate of incentives is a low batting average. To have benefits greater than costs, incentives must do something special—they either need unusually high benefits per job created, or incentive designs must exceed the typical batting average, lowering costs per job created.

Higher benefits per incented job can be achieved if incentives target high-wage or high-tech industries. High-wage industries obviously are good for those industries' workers. In addition, because higher-wage workers have more income to spend at local retailers, such industries will have higher multiplier effects in creating other local jobs. Because high-tech industries tend to cluster, incented high-tech jobs might also have higher multipliers, with each induced high-tech job creating five other local jobs (Moretti 2010).

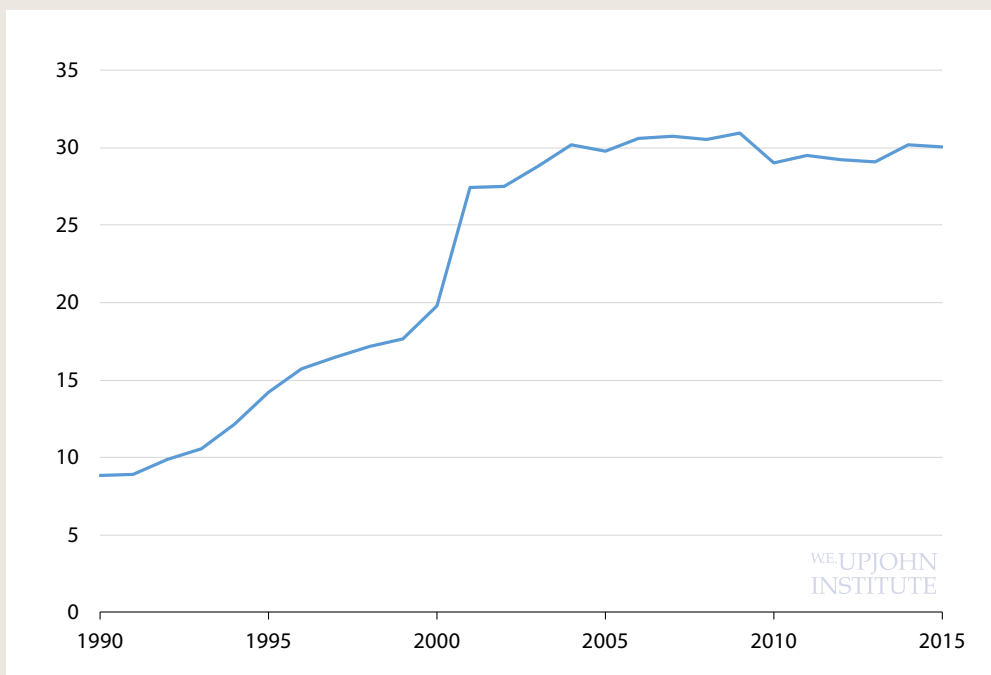
Incentives Vary Little across Industries

Even though some industries offer much greater benefits, the typical state does little industry targeting. As shown in Figure 3, higher-wage industries do not receive significantly higher incentives. Incentives do not particularly target high-tech, as each extra 10 percent of industry R&D spending only increases incentives by 0.3 percent.

Incentives are Excessively Long Term

Incentives are more effective if they are more up front. Because business executives tend to think in the short term, an incentive today is more effective at inducing location decisions than an incentive that is only paid out 10 years from now. The average state has incentives that are still 1.1 percent of business value-added when a facility is in its tenth year of operation. Reducing such long-term incentives would lower long-term government costs of incentives without having much effect on job creation.

Figure 1 Incentives as a Percent of Business Taxes, 1990–2015



NOTE: Chart shows the average magnitude of state and local business incentives as a percent of state and local business taxes, 1990–2015.

SOURCE: Author's calculations.

States Underinvest in Customized Business Services

Incentives designed as customized services may be more effective than tax incentives. For example, customized job training is a very effective incentive. Research suggests that, per dollar, customized job training might be 10 times more effective than tax incentives in encouraging local business growth (Hollenbeck [2008]; Hoyt, Jepsen, and Troske [2008]; see also Holzer et al. [1993]). Other effective customized services include manufacturing extension programs, which have been shown to improve productivity (Jarmin 1998).

Why are such customized services more cost-effective? They tend to be more targeted than tax incentives at small and medium-sized businesses, whose location and expansion behavior is easier to affect than large businesses'. Because obtaining quality job training

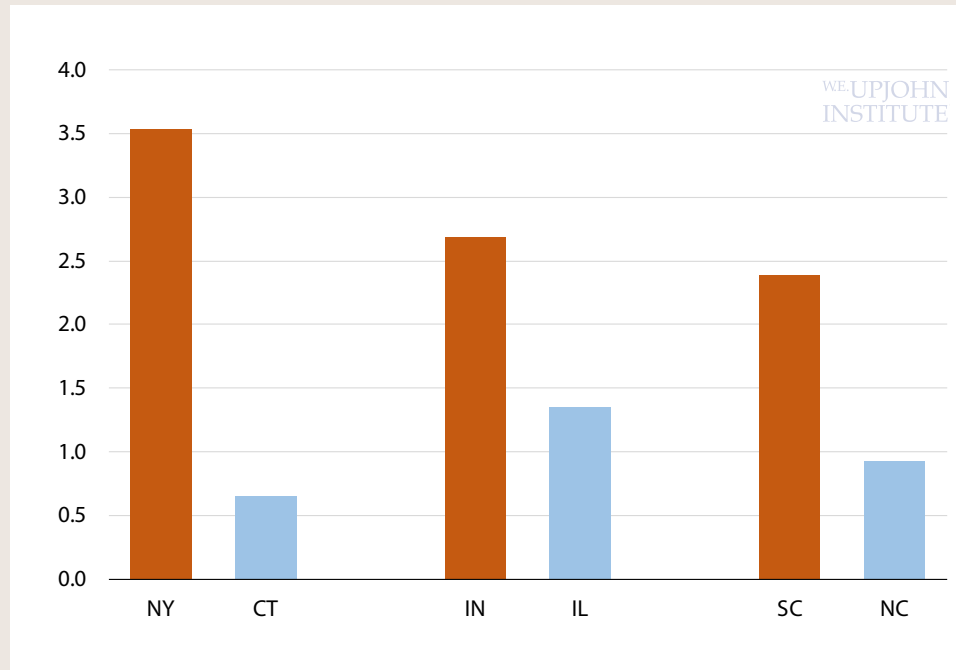
services or business advice may be difficult for smaller businesses to do on their own, the value of such services may exceed their costs. Finally, customized services provide up-front assistance, helping the business be more productive immediately.

However, despite the greater cost-effectiveness of customized services, state and local incentives are more focused on tax incentives. For example, the typical state only spends \$1 on customized job training for every \$20 devoted to tax incentives.

Summary

While these conclusions are based on preliminary analysis of the “Panel Database on Incentives and Taxes,” the database allows for much more extensive examinations of different types of incentives for each state for diverse industries. Such detailed analyses can play an important role in the growing national movement toward subjecting incentives to greater transparency, evaluation, and accountability. According to the Pew Charitable Trusts (2016), “Since 2012, 22 states and the District of Columbia have enacted laws requiring regular, rigorous, independent evaluation of tax incentives.” In addition, in 2015, the Governmental Accounting Standards Board adopted a new reporting standard, GASB 77, under which state and local governments that comply with “generally accepted accounting principles” must annually report at least the aggregate revenue foregone from each tax incentive program (Good Jobs First 2015). The database complements GASB 77 reports by providing more long-term and industry-detailed information on incentives. It supports state incentive evaluations by facilitating comparisons across states, industries, and incentive types. With better data and evaluation of incentives, state and local governments over time can reform such incentives to increase their benefits for state residents relative to costs.

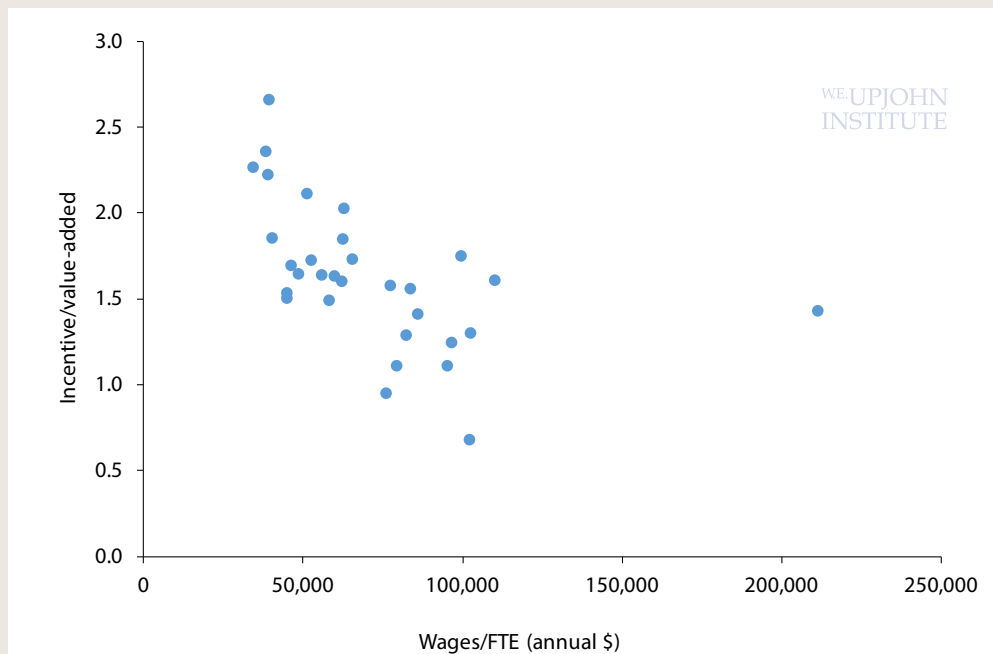
Figure 2 Incentives across Nearby States as a Percent of Value-Added, 2015



NOTE: Chart shows state and local business incentives as a percent of business value-added across three pairs of adjacent states as of 2015.

SOURCE: Author's calculations.

Figure 3 Comparison of Incentives vs. Wages across Industries, as of 2015



NOTE: Each dot represents 1 of 31 export-base industries. The vertical axis shows the national average for state and local business incentives for that industry, as a percent of that industry's value-added. The horizontal axis shows the industry's average wages per full-time equivalent worker.

SOURCE: Author's calculations.

Better Incentives Data Can Inform Both Research and Policy

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Working Longer, Retiring Later

Are Employers Ready for the New Employment Trend?

Robert L. Clark and Melinda Sandler Morrill

Policy analysts, economists, and demographers argue that individuals must extend their work lives if they are to achieve their desired standards of living in retirement. Increases in longevity imply that those who leave the labor force at traditional retirement ages must either save more during their working careers or consume less during their retirement.

The logic behind later retirement from the employee's perspective is clear and has been studied in detail: remaining in the labor force for additional years is needed to support increasing years in retirement. However, relatively few studies have directly addressed how employers feel about having workers remain on the job until older ages. Our book, *Extending Work Life: Can Employers Adapt When Employees Want to Delay Retirement?*, which was recently published by the Upjohn Institute (see p. 7), seeks to fill this gap by providing a comprehensive assessment of the costs and benefits to employers of accommodating later retirement ages. Through their employment and compensation policies, employers can either assist or restrict workers' ability to remain on the job.

Economic theory of the firm indicates that companies determine the optimal number of workers to

hire and the appropriate age and skill composition of their workforces. A firm will need a mix of employees of different skill types, skill levels, and vintages of human capital. Changes in the age structure of a firm's workforce due to delayed retirement can affect labor costs, productivity, profitability, and sustainability. Companies develop their compensation policies to attract, retain, motivate, and ultimately retire their desired workforces. As a result, shifts in worker preferences may lead to changes in company policies.

Employers must consider the advantages and costs of retaining or hiring older workers. Older workers often are relatively highly compensated, and some will experience diminished productivity at older ages. Furthermore, as employers retain older workers, the opportunities for advancement by younger workers might be restricted. Employers must address the changing demographics in their workforces. By creating compensation and employment policies to accommodate prolonged or delayed retirement transitions, employers will be better positioned to reap the benefits of employing older workers.

What factors influence a firm's willingness to retain older workers? Can companies develop transitional

ARTICLE HIGHLIGHTS

■ Between 1994 and 2014, the labor force participation rate for men aged 65–69 rose from 27 to 36 percent.

■ By creating compensation and employment policies to accommodate prolonged or delayed retirement transitions, employers will be better positioned to reap the benefits of employing older workers.